(10)

SEP 22 1944
CHARLES ELMORE CROPLEY

Supreme Court of the United States

October Term—1944.

No. 414.

CONSOLIDATED REALTY CORPORATION, REALTY ASSOCIATES SECURITIES CORPORATION, Debtor and AMALGAMATED PROPERTIES, INC.,

Petitioners,

AGAINST

EDWIN B. MEREDITH, JACOB R. SCHIFF, and MILTON C. ZAIDENBERG, constituting the Bondholders' Protective Committee; JOHN VANNECK, BARBARA B. VANNECK, EQUITABLE HOLDING CORPORATION, VANNECK REALTY CORPORATION and FRANK BAILEY; ANNA KUHLMANN and CATHERINE KUHLMANN,

Respondents.

Brief of Respondents in Opposition to Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

LLOYD B. KANTER, JULIUS SILVER,
Counsel for Bondholders' Protective Committee, Respondents.

PERCIVAL E. JACKSON,
Counsel for John Vanneck, Barbara B. Vanneck, Equitable Holding Corporation, Vanneck Realty Corporation and Frank Bailey, Respondents.

ARCHIBALD PALMER,
Counsel for Anna Kuhlmann and Catherine Kuhlmann, Respondents.

LODER APPEAL PRESS, INC., 65-67 Duane St., N. Y. C., Tel. WOrth-2-0689

INDEX.

	PAGE
Preliminary Statement	1
Opinions Below	2
The Petitioners	2
Statement of the Case	2
Rulings of the Courts Below	2
Questions Presented	4
ARGUMENT:	
I.—The Circuit Court of Appeals has merely stated and applied the unquestioned rule that a person with dual interests and conflicting loyalties may not act as trustee	5
II.—Petitioners are not aggrieved by the decision of the Circuit Court of Appeals and, therefore, are not entitled to review the order removing Mr. Thralls	13
III.—The Petition for Writ of Certiorari Should Be Denied	17

CASES CITED.

PAGE

Bosworth v. Terminal R. R. Association, 174 U. S. 182, 189 14

Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 125-127 16

City Bank Farmers Trust Co. v. Cannon, 291 N. Y. 125, 131 8

Globe Woolen Co. v. Utica G. & El. Co., 224 N. Y. 483, 489 12

In re Los Angeles Lumber Products Co., 46 F. Supp. 77 8

In re Mountain States Power Co., 118 F. (2d) 405 8

In re Michigan-Ohio Building Corporation, 117 Fed. 2nd 191, 193 16

In re National Public Service Corp., 68 F. (2d) 859, 863 8

In re Norcar Mfg. Co., 109 F. (2d) 407, 411 8

Keller v. Potomac Electric Power Company, 261 U. S. 428, 443 15

Michoud v. Girod, 4 How. 503 ..... 8, 9

Meinhard v. Salmon, 249 N. Y. 458, 464 12

Weil v. Neary, 278 U. S. 160, 173 13

Wilson v. Continental Building & Loan Association, 232 Fed. 824 8

Woods v. City National Bank & Trust Co., 312 U. S. 262 ..... 8, 9, 10

AUTHORITIES AND STATUTES CITED.

Remington on Bankruptcy, 5th Ed. Vol. 8, Section 3755 14

Bankruptcy Act, Section 160 14

48 Harvard Law Review 1, 8 8

Supreme Court of the United States

No. 414.

CONSOLIDATED REALTY CORPORATION, REALTY ASSOCIATES SECURITIES CORPORATION, Debtor and AMALGAMATED PROPERTIES, INC.,

Petitioners,

AGAINST

EDWIN B. MEREDITH, JACOB R. SCHIFF, and MILTON C. ZAIDENBERG, constituting the Bondholders' Protective Committee; JOHN VANNECK, BARBARA B. VANNECK, EQUITABLE HOLDING CORPORATION, VANNECK REALTY CORPORATION and FRANK BAILEY; ANNA KUHLMANN and CATHERINE KUHLMANN,

Respondents.

Brief of Respondents in Opposition to Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

Preliminary Statement.

This brief is submitted by the respondents Edwin B. Meredith, Jacob R. Schiff and Milton C. Zaidenberg, constituting the Bondholders' Protective Committee and by John Vanneck, Barbara B. Vanneck, Equitable Holding Corporation, Vanneck Realty Corporation and Frank Bailey; Anna Kuhlmann and Catherine Kuhlmann, bondholders of the Debtor, in opposition to the petition for a writ of certiorari to review the judgment of the Circuit

Court of Appeals for the Second Circuit, reversing two orders of the District Court of the United States for the Eastern District of New York, which orders denied motions to vacate the appointment of the additional trustee and overruled objections to the continued retention of the additional trustee in office.

Opinions Below.

The opinion of the Circuit Court of Appeals for the Second Circuit (R. 373) is not yet reported. The judgment below (Judge Learned Hand dissenting) reversed two orders of the District Court. In deciding the motion which resulted in the first order (R. 112-133), the District Judge rendered an oral opinion (R. 112). The opinion (R. 352-354) of the District Judge, upon which the second order (R. 355-358) was entered, is reported in 54 F. Supp. 785.

The Petitioners.

The petitioners are the Debtor, Realty Associates Securities Corporation, its sole stockholder, Consolidated Realty Corporation and Amalgamated Properties, Inc., a wholly owned subsidiary of the common stockholder, appearing herein as a bondholder of the Debtor.

Statement of the Case.

We omit a complete statement of facts herein and rely therefor on the memorandum of the Securities and Exchange Commission. In the course of the argument, we will set forth such facts as are particularly pertinent thereto.

Rulings of the Courts Below.

Respondents who constitute the Bondholders' Protective Committee moved to vacate the appointment of Mr.

Thralls as additional trustee; that motion was denied on November 4, 1943 (R. 112, 113). At the hearing held pursuant to the provisions of Sections 161 and 162 of the Chandler Act all respondents and the Securities and Exchange Commission objected to his continued retention as additional trustee.

The bases of the objection, and the issues raised by the present respondents on the appeal below (the District Court having overruled the objections) were threefold:

1. That an operating Trustee should be appointed only in the exceptional case and there was no need for the appointment of one in this proceeding.

2. That were one needed only an operating official of the company, which Mr. Thralls was not, should have been selected.

3. That Mr. Thralls had adverse interests which in any event disqualified him from acting as a trustee.

The Circuit Court of Appeals found it unnecessary to pass upon the first two issues. It decided the appeal, and reversed the orders of the District Court, upon the third ground. It held that Mr. Thralls as an additional trustee and as the representative of the Reconstruction Finance Corporation in many corporations of the Prudence Group with which the Debtor had and is likely to have business dealings will, necessarily, be under a cross-fire of conflicting loyalties. It concluded that the appointment of a person having such dual interests was improper; that section 158 (4) expressly forbade it and there was nothing in the words or policy of Section 156 to preclude giving effect to that rule.

This determination necessarily rendered the former questions moot and, as we will demonstrate herein, the decision of the Circuit Court that a person having dual interests could not be appointed a trustee, in fact and effect, merely required the application of *a well-settled substantive rule applicable to all trustees in bankruptcy, whether reorganization or otherwise, equity receivers and fiduciaries generally.*

We submit further, *that petitioners are not aggrieved parties* and, therefore, they have no right to attempt to review the determination made below that a particular individual, Mr. Thralls, should not act as trustee, additional or otherwise.

Questions Presented.

We submit, therefore, that the questions presented by this petition for certiorari are:

1. May a director of the Debtor be appointed as additional trustee in a Chapter X proceeding, where by reason of his official connection with other corporations which had and will continue to have business transactions with the Debtor, he is acting in a dual capacity and is subject to a cross-fire of conflicting loyalties?

2. Are petitioners entitled to seek a review of the determination of the Circuit Court of Appeals removing an additional trustee?

ARGUMENT.

I.

The Circuit Court of Appeals has merely stated and applied the unquestioned rule that a person with dual interests and conflicting loyalties may not act as trustee.

The record discloses that since October, 1935, Mr. Thralls has been the employee of Reconstruction Finance Corporation, the indirect owner of all the common stock of the Debtor herein (R. 284, 172, 173). He became a member of the Board of Directors of the Debtor in March, 1935, to represent the interests of Reconstruction Finance Corporation (R. 305, 319) and a member of its Executive Committee in 1939 (R. 305). Mr. Thralls' duties as an employee of the Reconstruction Finance Corporation entailed his representation of its interests in the numerous other corporations, forming the so-called Prudence Group of mortgage and real estate companies, of which the Debtor had been one (R. 175, 291). The interest of the Reconstruction Finance Corporation in these Prudence companies arose out of a $20,000,000 loan which it had made in 1932 to The Prudence Company, Inc., the loan being guaranteed by the New York Investors, Inc., and secured by the stock interests of that corporation in a number of companies, including the Debtor (R. 172, 174). In some of these corporations, such as the Debtor, there is a large public creditor interest superior to that of Reconstruction Finance Corporation; in others there is not (R. 145). As special representative of Reconstruction Finance Corporation, Mr. Thralls, in addition to his connection with the Debtor, became and now is a director and president of Allied Owners Corporation (R. 307), a director of Realty Associates, Inc. (R. 307); a director of Prudence-Bonds Cor-

poration (R. 308); a director and chairman of the Executive Committee of the Prudence Realization Corporation (R. 309); a director of Prudence Securities Corporation (R. 310); a director, vice-president and general manager of 58-59 Realty Corporation (R. 310); a director, vice-president and general manager of the Amalgamated Properties (R. 311), and a director of Hotel Taft (R. 311).

Many of these corporations have had and continue to have business transactions with the Debtor (R. 309-311, 322-324) and this is particularly true of Realty Associates, Inc., which shared offices and officers with the Debtor under an arrangement whereby the Debtor paid 67½% and Realty Associates, Inc. 32½% of the expenses involved (R. 45, 46).

The conflict of interest between the Debtor and several of these corporations is patent. In one instance, the Debtor owns the equity in real estate and Prudence Bonds Corporation owns the mortgage (R. 322); in another, the Debtor owns senior bonds and Prudence Realization Corporation the subordinate bonds of The Prudence Company, Inc. (R. 147). Transactions between Realty Associates, Inc., and the Debtor have resulted in several situations where the Debtor owns the mortgage and Realty Associates, Inc., the equity (R. 294).

When these corporations have business dealings with the Debtor, they concern matters where their respective interests are necessarily adverse (R. 146, 294, 322).

Mr. Thralls' admitted practice as a director of the Debtor bears on the necessity for the determination by the Circuit Court of Appeals that he should not be a trustee. When one of these transactions occurred between the debtor and a corporation of which he was director Mr. Thralls would partictipate in the discussion on both Boards and give his opinion (R. 323). He would try to

persuade his fellow members and get them together on what he considered a fair price (R. 324). He saw no conflict between his duty as a director of the prospective seller and as a director of the prospective purchaser (R. 322, 323). Though, perhaps to conform to some corporate ritual, he would not vote on the transaction (R. 322).*

These conflicts are further aggravated by the sharp division of interests between the bondholders and the sole common stockholder of the Debtor, the only classes affected by these proceedings. The bondholder seeks payment of the obligation due him, the common stockholder wants the assets held in the hope that in the future a greater price may be realized. Mr. Thralls went on the Board of Directors of the Debtor to represent and protect the interests of the common stockholder in the picture as against anybody else (R. 318, 319). True, as petitioners state, the proposed sale of any asset must be submitted to the court for its approval (R. 323, 354). But (and what may be more important to the bondholders) the determination not to sell, to refuse an offer, is one on which the parties are not heard and the court is not consulted. In that negative decision the operating trustee plays a major role and he, in this instance, is under a cross-fire of conflicting loyalties.

We submit that the Circuit Court was compelled to conclude that an officer of the Court could not be placed in such a position; that one who had such dual interests and was subject to such conflicting loyalties could not be a trustee.

The Court below, therefore, held that the prohibition contained in section 158 (4) against the appointment of one having a materially adverse interest applied equally to an additional trustee. To have held otherwise (that

*As a trustee, he has adopted the identical practice under similar circumstance (*post*, p. 10).

an additional trustee may be appointed though he has a materially adverse interest) *would have been to overrule the heretofore unquestioned substantive rule that one may not be appointed an officer of the Court if he is subject to conflicting loyalties arising out of dual interests that he represents.* That doctrine is hardly a novel one requiring review by this Court. Chief Justice Stone has stated that this basic principle embodies "the precept as old as holy writ, that 'a man cannot serve two masters'. * * * No thinking man can believe that an economy built upon a business foundation can long endure without loyalty to that principle." The Public Influence of the Bar, 48 Harv. L. Rev. 1, 8.

The Court below did not hold broadly that all of Section 158 applies to an additional trustee, which petitioners assume was the holding of the Court in their statement of the "Questions Presented". It merely held that the additional trustee could not have materially adverse interests, forbidden expressly by Section 158 (4), forbidden not only by that subdivision but by repeated decisions applicable to trustees in bankruptcy* (*Wilson* v. *Continental Building & Loan Association,* 232 Fed. 824; Cf. *In re National Public Service Corp.,* 68 F. [2d] 859, 863), equity receivers (*In re Norcar Mfg. Co.,* 109 F. [2d] 407, 411 and fiduciaries generally [*Michoud* v. *Girod,* 4 How. 503; *City Bank Farmers Trust Co.* v. *Cannon,* 291 N. Y. 125, 131]). So too has this rule been consistently applied to fiduciaries in reorganization proceedings: to the director of a debtor in possession (*In re Los Angeles Lumber Products Co.,* 46 F. Supp. 77) and to committee members (*Woods* v. *City National Bank & Trust Co.,* 312 U. S. 262; *In re Mountain States Power Co.,* 118 F. [2d] 405).

*Section 45 requires only that a bankruptcy trustee be "competent" and reside or have an office in the judicial district.

This Court stated in *Michoud* v. *Girod, supra*:

> "The general rule stands upon our great moral obligation to refrain from placing ourselves in relations which ordinarily excite a conflict between self-interest and integrity. * * * In this conflict of interest the law wisely interposes. It acts not on the possibility that, in some cases, the sense of that duty may prevail over the motives of self-interest, but it provides against the probability in many cases, and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty (p. 555). * * *
>
> Is it not better that the cause of the evil shall be prohibited, than that courts of equity shall be relied upon to apply the remedy in particular cases, by inquiring into all the circumstances of a case, whether there has or has not been fraud in fact?" (p. 557).

And its language in *Woods* v. *City National Bank & Trust Co., supra,* is particularly pertinent.

> "A fiduciary who represents security holders in a reorganization may not perfect his claim * * * by insisting that although he had conflicting interests, he served his several masters equally well or that his primary loyalty was not weakened by the pull of his secondary one" (p. 269).

Any other determination would be intolerable. If an additional trustee may have conflicting interests, as he may if the substantive rule repeated by the language of 158 (4) has no application to him, why may he not act in matters where those conflicting loyalties come into play?

There would be no statutory prohibition, and the broad judicial injunction would be held inapplicable. Judge Hand's assumption that such an appointment might stand if the "adverse interest" situations can be ascertained and if the operating trustee will withdraw from all such, in itself posits a limited application of the language of 158 (4). An application so limited would be impossible of practical enforcement. For how are these restrictions to be applied and enforced? How will the Court, or the trustee, or the creditors be assured that it is adhered to strictly. " * * * the incidence of a particular conflict of interest can seldom be measured with any degree of certainty". *Woods* v. *City National Bank & Trust Co.*, 312 U. S. 262, 268.

Despite the integrity of the additional trustee, in practice, the line of demarcation was ignored. Mr. Thralls as trustee conducted himself in the same fashion as he had as a director. The brief of the Securities and Exchange Commission to the Court below in citing one instance from the records of the District Court stated:

> "To illustrate how these precautions are operating during the trusteeship, we quote in part from an affidavit of Jerome Thralls, dated February 2, 1944, filed in the District Court but not a part of the present record:
>
> 'That when the offer of S. Knepper Realty Corp. for the purchase of the interests of the Trustees in premises 430 East 86th Street was transmitted to the Trustees, deponent (Mr. Thralls) participated in working out the arrangements which resulted in the contract for which approval is sought. That as a result of such arrangements an offer was made by the disinterested Trustees to Prudence Realization Corporation for a satisfaction

of its interest in the above mentioned second mortgage or an assignment thereof to S. Knepper Realty Corp.

That deponent discussed the proposed offer with the disinterested Trustees, and when that offer was transmitted to Prudence Realization Corporation he discussed it with his fellow directors of that corporation but did not vote thereon as such director. That after considering such offer, Prudence Realization Corporation made a counter-offer to the Trustees herein. That deponent discussed this counter-offer with the Trustees but did not vote on the question of its acceptance or rejection by them. That he arranged a conference of representatives of Prudence Realization Corporation and the disinterested Trustees herein, at which it was agreed that said Trustees would purchase from Prudence Realization Corporation its one-quarter coordinate interest in the second mortgage for the consideration of $8,500 to be paid out of the proceeds to be realized from the contract entered into between the Trustees of the Debtor and S. Knepper Realty Corporation for the purchase by said corporation of $118,000 principal amount of first mortgage certificates; a second mortgage in the reduced principal sum of $133,402 on premises known as 430 East 86th Street, and the fee to said premises.

Deponent is of the opinion that to accept the offer of S. Knepper Realty Corp. for the interests of the Trustees in premises 430 East 86th Street, including the one-quarter coordinate interest in the second mortgage owned by Prudence Realization Corporation, now under contract of sale to the Trustees of the Debtor, is to the best interests of the estate herein.' "

The only fitting comment to such adherence to what Mr. Thralls believed to be the letter of the law, in total disregard of its essential spirit, is the language of Judge Cardozo: "But 'the great rule of law' * * * which holds a trustee to the duty of constant and unqualified fidelity, is not a thing of forms and phrases. A dominating influence may be exerted in other ways than by a vote." (*Globe Woolen Co.* v. *Utica G. & El. Co.*, 224 N. Y. 483, 489.)

These encroachments in situations where the conflict of interest is obvious point the emphasis with which the Courts have repeatedly stated that if the barrier is lifted in supposedly exceptional cases the eventual destruction thereof will be inevitable.

> "Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyality by the 'disintegrating erosion' of particular exceptions. * * * Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court." *Meinhard* v. *Salmon*, 249 N. Y. 458, 464.

When this problem of present and potential conflict was presented to the District Court, it stated:

> "The Court has full faith in the judgment of the disinterested trustees whom it has appointed and if a situation should arise where there is any conflict of interest, the Court believes that Mr. Thralls will come forward and so state to the Court. Certainly the disinterested trustees and the attorneys for the trustees will also call the attention of the Court to any such instance. We also have a great number of attorneys who have appeared in

this proceeding and they would call the Court's attention to any evidence of that character" (R. 354).

The assumption that it suffices if all parties to the proceeding act as watch-dogs of the Court's appointee creates a situation so dangerous and so fraught with the possibility of evil as to demand and compel removal from trust obligations. "What is struck at * * * is not only actual evil results but their tendency to evil in other cases." (*Weil* v. *Neary*, 278 U. S. 160, 173.)

The Circuit Court of Appeals did no more than apply this salutary rule to the instant case—a principle which has long since been settled by this Court.

We respectfully submit that such a determination does not require review by this Court.

II.

Petitioners are not aggrieved by the decision of the Circuit Court of Appeals and, therefore, are not entitled to review the order removing Mr. Thralls.

We feel so strongly that there is no question for consideration by this Court, and that this petition should be disposed of upon that ground that we hesitate to burden the Court with the contention that in any event these applicants have no right to maintain this appeal, yet it would seem that that is so.

The petition for the writ assumes that the rights of petitioners have been adversely affected by the removal of Mr. Thralls. That assumption is palpably fallacious. No one, not *even Mr. Thralls*, may any more claim to be aggrieved by the removal than would have been the case if the District Judge had refused to appoint him on the approval of the reorganization petition and, of course, no

one's rights could have been adversely affected by such refusal.

Section 160 of the Bankruptcy Act provides that "* * * *the judge, at any time, without or upon cause shown, may* * * * *remove trustees* * * *." (Italics ours.)

The plain import of this section is that a trustee does not, by his appointment, acquire a right to continue in the office and, as a corollary to the absence of such a right, neither the debtor, nor any stockholder or creditor of the debtor has any right to a particular individual's continuance in office. From this it is manifest that neither a removed trustee* nor anyone else is in a position to review an order of *removal.* The statute has conferred upon the judge the *absolute* right to dispense with the services of a trustee at any time and no one can assert that the removal violates a right to have the trustee continue to serve. Nor is there any statutory provision which vests in any party the right to assert that any particular person be appointed or continued as trustee.

Of course, a debtor, or a stockholder or creditor of the debtor, may move, at any time, for a trustee's removal "upon the ground that he is not qualified or not 'disinterested' as provided in Section 158" of the Act (see Section 162) and, if removal be denied, the moving party would be aggrieved for the obvious reason that the continuance of the trustee in office may cause injury and damage.† *That was the position of the respondents on*

*Thralls evidently recognizes that he has no right of appeal from the decision removing him. See *Bosworth* v. *Terminal R. R. Association*, 174 U. S. 182, 189, in which the court held that a receiver in an equity proceeding "may not appeal from the order discharging or removing him". Corpus Juris Secundum, Vol. 4,§203, p. 383 states that " * * * a receiver (or trustee appointed by the court) may * * * not appeal from an order or decree removing or discharging him or vacating his appointment * * *."

†Remington, in his work on Bankruptcy, 5th Ed. Vol. 8, Section 3755, says that "*Creditors* * * * have standing to review orders appointing trustees". The omission to state that creditors have the right to review an order removing a trustee is significantly indicative that such a right is *non-existent* because removal does not and cannot conceivably result to their prejudice.

the appeals which resulted in the decision removing Thralls.

It follows, therefore, that while parties may be adversely affected by an order *denying removal* of a trustee and may appeal therefrom, *no one is aggrieved by an order removing a trustee* and an appeal from such an order will not lie. Had the District Judge refused to appoint Thralls or, having appointed him, granted the motion for his removal or sustained the objections to his continuance, petitioners could not have appealed from the order because they would not have been aggrieved. So too they may not review the decision of the Circuit Court of Appeals removing him.

Nor may it be urged that because the removal was by the decision of the Circuit Court of Appeals and not by the District Judge, the situation is different so far as petitioners' interests are concerned. Such an argument would be untenable for the effect of the decision of the Circuit Court of Appeals is the same as if it were the decision of the District Judge in the first instance. This court held in *Keller* v. *Potomac Electric Power Company*, 261 U. S. 428, 443, that a decision of an appellate court in an equity cause, reversing the District Court, is to be treated as though it were the determination of the District Court on its original disposition of the matter. Thus, the question whether petitioners are aggrieved must be regarded as though the District Judge had granted the motion for Mr. Thralls' removal or had refused to permit him to continue in office over the objection of the committee and other bondholders. In such case petitioners would not have the right to appeal from the District Court's order and, accordingly, they are not entitled to review the decision of the Circuit Court of Appeals.

Mr. Thralls is a director of the debtor; a director, vice-president and general manager of petitioner Consolidated Realty Corporation which owns all the capital stock

of the debtor; and a director, vice-president and general manager of petitioner Amalgamated Properties, Inc. It is quite understandable that petitioners are disappointed and, perhaps, chagrined that Mr. Thralls may no longer act as a trustee of the debtor and, in such capacity, to some extent control the destinies of the debtor. But that disappointment or chagrin is not tantamount to aggrievement which, in law, entitles one to appeal from the decision removing him from the office of trustee. The decision of the Circuit Court cannot possess the petitioners with a right which statutory mandate not only did not give them but in fact denied to them.

The language of this court in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 125-127, is peculiarly appropriate:

> "A Debtor * * * who invokes the aid of the Federal Courts in reorganization * * * assumes all the consequences which flow from that jurisdiction * * *. The court need not keep the debtor in possession but may substitute for the old management a trustee * * *. He (the debtor) invokes that jurisdiction risking all the disadvantages which may flow to him as a consequence, as well as gaining all the benefits * * *. *The right to remain in unmolested dominion and control over the property was necessarily waived or abandoned on invoking the jurisdiction of the Federal Courts in these proceedings.*" (Italics ours.)

As to petitioners, it may be said, as the court wrote in *In re Michigan-Ohio Building Corporation*, 117 Fed. 2nd 191, 193:

> "They are in no wise aggrieved; they are deprived of no property or right; upon them is im-

posed no burden. If there are ever to be any consequences resulting to their injury, they are not reflected by the record. Nothing would justify us in concluding that they are even remotely affected by the decree."

Because petitioners are not aggrieved by the decision removing Mr. Thralls as a trustee of the debtor, they may not be allowed a writ to review such decision.

III.

The Petition for Writ of Certiorari Should Be Denied.

LLOYD B. KANTER, JULIUS SILVER,
Counsel for Bondholders' Protective Committee, Respondents.

PERCIVAL E. JACKSON,
Counsel for John Vanneck, Barbara B. Vanneck, Equitable Holding Corporation, Vanneck Realty Corporation and Frank Bailey, Respondents.

ARCHIBALD PALMER,
Counsel for Anna Kuhlmann and Catherine Kuhlmann, Respondents.



INDEX

	Page
Preliminary statement	1
Opinions below	2
Jurisdiction	2
Question presented	3
Statutes involved	3
Statement	3
Argument	7
Conclusion	15
Appendix	16

CITATIONS

Cases:	
Atkins v. *Wabash, St. L. and P. Ry. Co.*, 29 Fed. 16	12
Coy v. *Title Guarantee & Trust Co.*, 157 Fed. 794	11
Finance Co. of Pa. v. *Charleston, C. & C. R. Co.*, 45 Fed. 436	12
King's Brewery, Inc., In re, C. C. H. Bankr. Serv., par. 3116	12
Lewensohn, In re, 98 Fed. 576	11
Olmstead v. *Distilling & Cattle Feeding Co.*, 67 Fed. 24	11
Rekersdres, In re, 108 Fed. 206	11
Weil v. *Neary*, 278 U. S. 160	14
Woods v. *City National Bank and Trust Co. of Chicago*, 312 U. S. 262	14
Statute:	
Bankruptcy Act as amended by the Act of June 22, 1938, C. 575, sec. 1, 52 Stat. 840:	
Section 45 (11 U. S. C. 73)	11
Section 114 (11 U. S. C. 514)	11
Section 115 (11 U. S. C. 515)	11
Section 156 (11 U. S. C. 556)	3, 11, 12, 16
Section 157	11
Section 158 (11 U. S. C. 558)	3, 11, 16
Section 187	11
Section 189 (11 U. S. C. 589)	3, 16
Miscellaneous:	
83 Cong. Rec. 9107 (75th Cong., 3d sess.)	8
S. Rep. No. 1916, 75th Cong., 3d sess	12

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 414

CONSOLIDATED REALTY CORPORATION, REALTY ASSOCIATES SECURITIES CORPORATION, DEBTOR, AND AMALGAMATED PROPERTIES, INC., PETITIONERS

v.

EDWIN B. MEREDITH, JACOB R. SCHIFF, AND MILTON C. ZAIDENBERG, CONSTITUTING THE BONDHOLDERS' PROTECTIVE COMMITTEE; JOHN VANNECK, BARBARA B. VANNECK, EQUITABLE HOLDING CORPORATION, VANNECK REALTY CORPORATION AND FRANK BAILEY; ANNA KUHLMANN AND CATHERINE KUHLMANN, ET AL.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

PRELIMINARY STATEMENT

Proceedings for the reorganization of Realty Associates Securities Corporation under Chapter X of the Bankruptcy Act are pending in the District Court for the Eastern District of New York (R.

35). The Securities and Exchange Commission, pursuant to Section 208 of the Bankruptcy Act (Act of June 22, 1938, c. 575, sec. 1, 52 Stat. 894, 11 U. S. C. § 608), became a party to the proceedings (R. 2). The district court appointed two trustees and an "additional trustee", Jerome Thralls (R. 69). Appeals to the circuit court of appeals were taken from two orders of the district court (R. 114, 359) which respectively denied a motion to vacate the appointment of Jerome Thralls as "additional trustee" of the debtor (R. 112–3) and overruled objections to his continuance in office (R. 355–8). The Commission opposed the retention of Thralls as additional trustee in the district court (R. 341–2) and in the court below. The orders of the district court were reversed by a divided circuit court of appeals (R. 373–8). The purpose of this memorandum is to endeavor to show that the decision of the court below is correct.

OPINIONS BELOW

The opinion of the circuit court of appeals reversing the orders of the district court (R. 373–7) and the dissenting opinion of Judge Learned Hand (R. 377) have not yet been officially reported. The formal opinion of the district court (R. 352–4) is reported in 54 F. Supp. 785.

JURISDICTION

The decree of the circuit court of appeals was entered August 8, 1944 (R. 378). The petition

for a writ of certiorari was filed August 30, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether an additional trustee appointed under Chapter X of the Bankruptcy Act is disqualified from such trusteeship by reason of conflicting interests arising out of dealings between the debtor estate and other corporations in which he is interested as officer or director.

STATUTES INVOLVED

The following sections of the Bankruptcy Act, as added by the Act of June 22, 1938, c. 575, sec. 1, 52 Stat. 840, are set forth in the Appendix, *infra*:

Section 156 (11 U. S. C. § 556)
Section 158 (11 U. S. C. § 558)
Section 189 (11 U. S. C. § 589)

STATEMENT

Voluntary proceedings for the reorganization under Chapter X of the Bankruptcy Act of Realty Associates Securities Corporation, hereinafter referred to as the debtor, were instituted on September 28, 1943 (R. 35). The debtor is a mortgage investment company engaged in making mortgage loans, dealing in mortgages and other real estate interests, and managing properties acquired through or in lieu of foreclosure (R. 35, 204–5).

This business, together with that of an affiliate company (Realty Associates, Inc.) not in reorganization, has been managed for many years by a group of officers headed by Frank Fox, president, and Harry D. Burchell, principal vice president (R. 45–6, 66, 178, 205, 234–5, 263–4, 270). At the time the debtor's petition was filed, the debtor was defraying 67½% of the salaries of the officers and employees engaged in the joint operation of the debtor and Realty Associates, Inc. (R. 46, 66). By the terms of the *ex parte* order approving the petition the district court, pursuant to Section 156 of the Act, appointed two reorganization trustees and authorized them to continue the employment of all the officers and to adopt the existing apportionment of salary expenses between the affiliated companies (R. 69–70). At the request of the debtor (R. 47) the court also appointed Jerome Thralls as additional or "operating" trustee for the purposes specified in Section 189 of the Act (R. 69).

Subsequent to taking office, the trustees decided to terminate, at least for the period of the reorganization, the combined operations with Realty Associates, Inc. Accordingly, the services of certain executives (including Fox) and other employees not needed for the debtor's operations were discontinued (R. 195, 205, 224–6, 256–7). Those remaining with the trustees were to devote full time to the debtor's affairs, were not to partici-

pate in the operation of the affiliated company (although joint offices are still maintained (R. 230)), and were to receive all of their compensation from the trust estate. Pursuant to this internal reorganization, Burchell is serving as senior officer in charge of operations, assisted by subordinate officers who supervise particular departments of the business (R. 202, 205–6, 263). In the opinion of the reorganization trustees the staff retained by the trustees is competent and adequate for the purposes or foreseeable demands of the business and no branch of the business is being neglected (R. 205–6, 208, 226).

Thralls became a director of the debtor in 1935 by reason of his position as Special Representative of the Reconstruction Finance Corporation (R. 173, 296, 353) which then held all the capital stock of the debtor as pledgee (R. 172). In 1939 the RFC became the absolute owner of this stock by foreclosure and thereafter transferred it to a wholly owned subsidiary, Consolidated Realty Corporation, which is one of the petitioners herein (R. 172). Thralls became and still is vice president and general manager of the Consolidated Realty Corporation (R. 173) and has held its proxy to vote the debtor's shares (R. 296). Since 1939 Thralls has been a member of the debtor's executive committee (R. 305). He has received compensation from the RFC for his services and in addition has received the usual fees from the

debtor as a director and member of the Executive Committee (R. 306, 67, 173, 315–6). He was never an operating officer of the debtor (R. 172–6). He testified he spent one 18-hour day a week on the affairs of both the debtor and Realty Associates, Inc. (R. 334, *cf.* 326). He makes his offices with the RFC rather than with the debtor (R. 230, 317).

In the matters in which the RFC is interested, including the debtor, Thralls' primary obligation is to protect the interests of the RFC (R. 318–9, 330). Moreover, as Special Representative of the RFC, he has connections as director or officer with the so-called Prudence group of companies which includes the debtor (R. 175, 307–11) and is in charge of the liquidation of a large RFC loan to the companies in this group (R. 173–4, 307). The interests of these companies, with which the debtor has had relationships in the past and with which the trustees will continue to have business transactions (R. 309–11), are adverse to the estate (R. 324). One of these companies is Realty Associates, Inc., of which Thralls is a director (R. 307). The stock of Realty Associates, Inc., like that of the debtor, is owned by petitioner Consolidated Realty Corporation (R. 66, 103). There have been instances where the two companies have embarked upon joint ventures with the result that the debtor holds mortgages on property in which Realty Associates, Inc. owns the equity. In other

situations, Realty Associates, Inc. holds a junior interest or participation in mortgages in which the debtor has the senior interest. As respects others of these companies, the debtor is in many instances the equity owner or junior participant and the other corporation in which Thralls has an interest is the mortgagee or the senior holder (R. 322). When such transactions have occurred prior to the debtor's reorganization Thralls has refrained from voting on the question although he has participated in the discussions and negotiations (R. 322–3).

The district court denied an application for an order vacating Thralls' appointment as additional trustee (R. 112–3) and overruled objections to his retention in office (R. 355–8). On January 28, 1944, the district court filed a formal opinion (R. 352–354). The circuit court reversed these orders of the district court. (R. 378).

ARGUMENT

I

The circuit court of appeals, in our opinion, properly held Thralls to be disqualified from serving as additional trustee by reason of his connections with companies whose interests are adverse to the interests of the creditors of the debtor and who have constant dealings with the estate.

We believe a clearer idea of the issues involved may be obtained by an examination of the status

of the case in the court below and the arguments presented to it by the respondents to support their claims that the additional trustee is disqualified. The arguments were as follows:

First, it was argued that the policy of Chapter X, as shown by its legislative and historical background, confines the appointment of additional trustees to the exceptional case. It contemplates the appointment of officers or directors as additional trustees only if they are active operating men whose services and experience are essential to the business operations of the trusteeship and only when these services cannot be obtained through their employment by the reorganization trustees.[1] The record was cited to show that Thralls' services were not needed because Burchell and other active operating officers of the debtor were employed by the trustees and that Thralls had not taken an active part in the operations of

[1] Representative Chandler, reporting the bill to the House, explained the purpose of the amendment in a formal statement as follows:

"Appointment of cotrustees (sec. 156): The Senate has deemed it advisable to amend this section so as to make it possible for the judge to appoint an officer or employee of the debtor as cotrustee for the single purpose of aiding in the management and operation of the debtor's business or property. *In the unusual case this may be desirable, and the Senate amendment supplies flexibility in this regard.* Since the disinterested trustee is empowered to employ officers of a debtor (sec. 191), such appointment of a cotrustee would not be necessary in the ordinary case." (Italics supplied) [83 Cong. Rec. 9107 (75th Cong., 3d Sess., June 13, 1938)].

the debtor before it filed its petition. We also urged this position in the court below and placed major emphasis on it. That court, however, found it unnecessary to pass on either the construction we urged or Thralls' qualifications under that construction. The court did state that "Regardless of which construction is correct it would seem that usually, in the interest of economy in administration, an 'additional', i. e. operating, trustee should not be appointed when the disinterested trustees retain in their employ the top operating officers and employees of the debtor" (R. 375).

Second, respondents urged that directors, officers or employees appointed as additional trustees under Section 156 of Chapter X are disqualified to serve under Section 158 (1) if they are stockholders or represent stockholders of the debtor. The record showed that Thralls, while not himself a creditor or stockholder of the debtor within the letter of subdivision (1), is vice-president and general manager of Consolidated Realty Corporation which is the sole stockholder of the debtor. We did not support this argument because we found difficulty in reconciling the provision for appointment of a director or officer as additional trustee with the disqualification of persons owning stock of the debtor in Section 158 (1); in the absence of a clear legislative declaration we hesitated to urge that the doubt be resolved by narrowing the

class from which additional trustees, when needed, might be selected. The court rejected the respondents' argument in this respect on the ground that the last sentence of Section 156, allowing the appointment of a director as an additional trustee, "implicitly removes the disqualification specified in section 158 (1) arising from ownership of the debtor's stock, since directors usually do own some stock" (R. 376).

Third, respondents contended that the basic policy of the Act to exclude "friendly" trustees from the reorganization process requires the appointment of additional trustees free of interests adverse to those of the estate. The record shows that Thralls, as Special Representative of the R. F. C., has connections as director or officer with corporations whose interests are in conflict with those of the estate. These are other companies in the Prudence group with which the debtor has had and is continuing to have business transactions. That this conflict is real is apparent from the fact that Thralls, although participating in the discussions and negotiations, has refrained from voting on questions involved in such transactions. We urged that these adverse interests disqualified the additional trustee.

The circuit court based its decision on this ground. The court concluded that the standards of disinterest specified in Section 158 are applicable to additional trustees except as modified, explicitly or implicitly, by the last sentence of

Section 156. It found that under subdivision (4) of Section 158 Thralls was disqualified because of interests conflicting with those of the estate.

We agree with this result. We believe it is immaterial whether the decision is based on Section 158 (4) or, as we argued in the court below, upon well-established equity receivership and bankruptcy principles inherent in the structure of Chapter X requiring trustees to be free from conflicting interests.[2] Because of our difficulty in reconciling the applicability of the stockholder provisions of Section 158 (1) to additional trustees, we avoided an argument depending upon any portion of Section 158. However, the manner in which the court below excluded the stockholder

[2] In ordinary bankruptcy, where Section 45 (11 U. S. C. 73) does no more than require a trustee to be "competent", the courts have expanded the term to require not only capability to perform the functions of a trustee but also freedom from "all entangling alliances or associations that might in any way control his complete independence and responsibility." See *In re Rekersdres*, 108 Fed. 206 (S. D. N. Y. 1901); see also *In re Lewensohn*, 98 Fed. 576 (S. D. N. Y. 1899). Cf. Section 157 (11 U. S. C. 557). Broad principles of disqualification arising from prejudicial associations were developed by the courts sitting in equity receiverships. See *Coy* v. *Title Guarantee & Trust Co.*, 157 Fed. 794 (1907); *Olmstead* v. *Distilling & Cattle Feeding Co.*, 67 Fed. 24 (C. C. N. D. Ill. 1895). Since the Chapter X court and its officers have the powers and duties, not inconsistent with the statute, which prevail in bankruptcy and equity receivership proceedings, the applicability of these general standards seems clear (see Secs. 114, 115, 187; 11 U. S. C. 514, 515, 587). In addition Section 156 requires that Chapter X trustees have the qualifications (other than residence) prescribed by Section 45.

disqualification in Section 158 (1) and applied the consistent portions of Section 158 appears to us to be a satisfactory solution of the difficulty.[3] The standards imposed by the court below pursuant to Section 158 (4) are identical with those which we urged as applicable independently of this provision. Regardless of the basis of the decision, it accords with the general purpose of Congress to place control of the estate during reorganization in the hands of impartial and disinterested trustees. Certainly the limited authorization for the appointment of an additional trustee was not intended to alter the inflexible rule that persons with such prejudicial associations are not competent to serve as trustees. There is no basis in fact for petitioners' criticism that the decision of the court below "unduly restricts the class from which Additional Trustees

[3] The basic necessity for impartiality and disinterestedness in court officers was recognized early in the history of equity receivership reorganizations. See *Atkins* v. *Wabash, St. L. and P. Ry Co.*, 29 Fed. 161, 173–174 (C. C. N. D. Ill. 1886); *Finance Co. of Pa.* v. *Charleston, C. & C. R. Co.*, 45 Fed. 436 (C. C. S. C. 1891). The relaxation of these standards in equity receivership and under Section 77 B of the Act (see *In re King's Brewery, Inc.*, C. C. H. Bankr. Serv., Par. 3116 (E. D. N. Y. 1934)) led to the enactment of Section 156 in its present form. Sen. Rep. No. 1916, 75th Cong., 3rd Sess. (1938) pp. 21, 27, 28. As the Senate Report stated: "Section 156 puts an end to the general practice of leaving the debtor in possession, or of appointing 'friendly' trustees, including officers of the debtor corporation, in proceedings under section 77B."

may be appointed" (Pet. 12). For while officers and directors usually hold stock, it is not true in any substantial number of cases that officers or directors will have conflicting interests of the type prohibited by the decision of the court below.

II

The circuit court properly held that Thralls' disqualification under Section 158 (4) cannot be waived either because of his integrity or because of his promise not to vote in decisions involving the conflicting interests of the other companies in the Prudence group. The dissenting opinion, while agreeing with the majority's interpretation of Section 156, felt that Thralls might be retained if the district court in its discretion was certain that Thralls would take no part in transactions in which he has "an interest materially adverse to the interests of any class of creditors" (R. 377). The dissenting judge assumed that each transaction involving a conflict could be ascertained and that the additional trustee "will withdraw from all such". (R. 377). These views run counter to the underlying purpose of the Act which was to fix standards for the appointment of trustees and, where materially adverse interests exist, not to leave such appointments to the discretion of district judges who might be oversanguine as to their ability to avoid the dangers

inherent in the appointment of trustees with such conflicting loyalties.

In the past and during these proceedings, Thralls has not withdrawn from transactions involving a conflict of his loyalties. He has merely refrained from voting on them, but has participated in the discusions and negotiations leading to those transactions. Whether or not this procedure is in accord with conventional corporate practice where there are interlocking directorates, we do not believe a court should rely on such limited precautions to insulate against conflicting interests of trustees. The high quality of the fiduciary obligations imposed upon a trustee, even an additional trustee, do not permit of such dual interests. It is not appropriate to speculate that because of the integrity of the particular individual actual harm will not occur, nor is it a sufficient safeguard that he and others who work with him are charged with the responsibility of bringing the conflicts into the open (R. 354). For, as this Court has stated in comparable situations, "the incidence of a particular conflict of interest can seldom be measured with any degree of certainty." *Woods* v. *City National Bank and Trust Co. of Chicago,* 312 U. S. 262, 268 (1941). "What is struck at . . . is not only actual evil results but their tendency to evil in other cases." *Weil* v. *Neary,* 278 U. S. 160, 173 (1929).

CONCLUSION

For the reasons stated, the Commission believes the decision below is correct.

Respectfully submitted.

ROGER S. FOSTER,
Solicitor,
MILTON V. FREEMAN,
Assistant Solicitor,
GEORGE ZOLOTAR,
W. VICTOR RODIN,
KIVA BERKE,
Attorneys,
Securities and Exchange Commission.

I have authorized the filing of this Memorandum.

CHARLES FAHY,
Solicitor General.

SEPTEMBER 1944.